



CITY OF HOUSTON

Finance and Administration Department

Interoffice

Correspondence

To: Budget and Fiscal Affairs Committee

From: Michelle Mitchell, Assistant Director
Department of Finance and Administration

Date: January 4, 2008

CC:

Subject: **Restructure of \$300 Million Taxable
Collateralized Pension Obligation Note**

The purpose of this memo is to provide information on the proposed restructuring of the \$300 million Taxable Collateralized Pension Obligation Note (the "Note") and related Deferred Interest Certificates. In light of current, favorable market conditions for taxable debt, it is prudent for the City to issue pension obligation bonds to replace the Note.

In November of 2004, as part of the Meet and Confer Agreement, the City issued a \$300 million collateralized taxable note, which constituted a funding of the City's commitment to the Houston Municipal Employee Pension System ("HMEPS"). This contribution to HMEPS helped in reducing the unfunded accrued liability. This Note is structured to mature on December 1, 2033 but is callable at any time, and is collateralized by the City's Convention Center Hotel. Issued in conjunction with the Note were two Deferred Interest Certificates, one of which is collateralized. These Deferred Interest Certificates were to be used when the City exercised its right under the agreement to defer interest on the Note. To date, the City has elected to defer approximately \$48 million in total interest payments.

Current market conditions indicate that an all in True Interest Cost (TIC) on the pension obligation bonds would be about 6%. Using this assumption and the assumption that the interest rate on the current Note remains at 8.5%, a savings of approximately 250 basis points could be realized. Additionally, HMEPS will receive cash proceeds, and with that, the opportunity for investment returns higher than 8.5%.

The Houston Airport System, Combined Utility System and the Convention and Entertainment Facilities funds will pay their share of the Note in cash. Thus, the total City outstanding debt will be reduced by about \$90 million. This will improve the balance sheet and debt ratios of the City as a whole.

In December the attached memo regarding the proposed issuance of Taxable Pension Obligation Bonds in the amount of approximately \$35 million for the Houston Police Officers Pension System ("HPOPS") was presented to the Budget and Fiscal Affairs Committee, and was favorably reported. At the time of that memo, the decision to replace the Note had not been finalized. Should the City decide to proceed on the restructuring of the \$300 million note as is recommended, the \$35 million HPOPS transaction will be combined with the larger bond issue. This would eliminate a duplication of effort, ensure the most economical pricing, and reduce expenses associated with these transactions.

The \$35 million payment to HPOPS must be completed by February 19, 2008. To insure that the payment to HPOPS is made on time, arrangements have been made with JP Morgan Chase Bank, N.A. for them to provide short term funding of the \$35 million. When the larger issue is closed, the \$35 million short-term note will be combined with the larger transaction.

The Taxable Pension Obligation Bonds, Series 2008A & B will be issued through a negotiated financing with JP Morgan & Co., Inc. serving as book running manager along with First Albany Capital Inc., Goldman Sachs & Co., and Ramirez & Co., Inc as co-senior managers. Bank of America, Morgan Stanley, RBC Dain Rauscher and Siebert Brandford will serve as co-managers. Vinson & Elkins LLP and the Law Offices of Francisco G. Medina will serve as co-bond counsel and Bracewell & Giuliani LLP and the Law Office of Lynette D. Bratton will serve as co-disclosure counsel. The co-financial advisors will be First Southwest Company and Estrada Hinojosa & Co., Inc.

Recommendation

The Finance Working Group recommends that the City proceed with these transactions.